

Adelaide CBD Office Market



April 2024

Effective rental growth continues its upward trend despite rising incentives for the majority of building grades, whilst flight to quality remains a compelling factor in tenant movements.

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Key Insights

Total vacancy rises amidst an influx of new supply, while divergence between grades continues to expand.



Bradley Tobiassen
Property Analyst, RESEARCH & CONSULTING

 **19.3%**

Total vacancy rising


Total vacancy increased from 17.0% in July 2023 to 19.3% in January 2024.

Prime vacancy = 22.0%
Secondary vacancy = 16.9%

 **+673**

Net absorption declines

Net absorption reduced from 14,270 sqm in July 2023 to 673sqm in January 2024, well below the 10-year average of 2,849sqm. However, prime net absorption was +3,945sqm.

 **65,063**

New supply to be delivered between now and 2025

New supply additions expected by the end of 2025 equate to 65,063sqm, significantly down on 2023 additions of 87,016sqm which is one of the strongest supply years on record.

 **6.9%**

Average CBD prime yield

The current average prime yield for CBD assets is 6.93%, 25 bps above the 10-year average of 6.68%. Adelaide's average prime yield is softer than Sydney (5.78%), Melbourne (6.25%) and Brisbane (6.88%).

 **3.4%**

Rental growth in H2 2023

Gross effective rents grew in both prime and secondary markets grew in 2023.

Prime - \$428 (3.37%)
Secondary - \$285 (3.27%)

 **\$13m**

H2 2023 transaction volumes (\$10m+)

Transaction volumes fell in the second half of 2023, with just one sale above \$10m.

Adelaide CBD Office Market Indicators – 1 January 2024

Grade	Total Stock sqm	Vacancy Rate %	Annual Net Absorption sqm	Annual Net Additions sqm	Av Gross Face Rent \$/sqm	Av Incentive %	Gross Effective Rent Gth % y/y	Core Market Yield %*
Prime	743,853	22.0%	3,945	50,773	649	34.1%	4.11%	6.93%
Secondary	819,712	16.9%	-3,272	-6,008	455	37.5%	3.99%	7.82%
Total	1,563,565	19.3%	673	44,765				

Source: Knight Frank Research/PCA * assuming WALE 5 years

Leasing market

VACANCY RISES AS NEW SUPPLY COMES TO MARKET

Amidst rising capital costs, which have cooled the investment market's fervour, demand for office space has remained upbeat. Despite a tapering of high-end asset enquiries in H2 2023, Adelaide's CBD office leasing market has defied broader economic pressures with a positive trajectory, consistently outstripping purchaser demand, and in turn spurring significant rental growth.

Irrespective of strong demand and rental growth, the vacancy rate in the Adelaide CBD increased from 17.0% to 19.3% in H2 2023, predominantly due to a considerable influx of new prime supply.

Analysing vacancy rates by property grade, prime CBD properties experienced a rise of 5.2 percentage points from 16.8% to 22.0% during the same period, while secondary vacancy rates decreased by 2 bps to 16.9%.

ABSORPTION BUCKS TREND AS INCENTIVES RISE

Net absorption remained positive in Adelaide, just, at +673sqm. A continued resilient showing by prime demand (+3,945sqm) was virtually cancelled out by the fall in secondary absorption.

The divergence reflects a market with an increased prime vacancy rate. Consequently, opportunity abounds for occupiers to relocate to newer, high-quality spaces fuelled by a strong development pipeline. This simultaneously highlights the ongoing complexities of repurposing older, vacated office spaces in a discerning leasing environment. It may well be that we will continue to see negative secondary absorption cancelling out positive prime absorption, as happened in the latest set of numbers, if this trend continues.

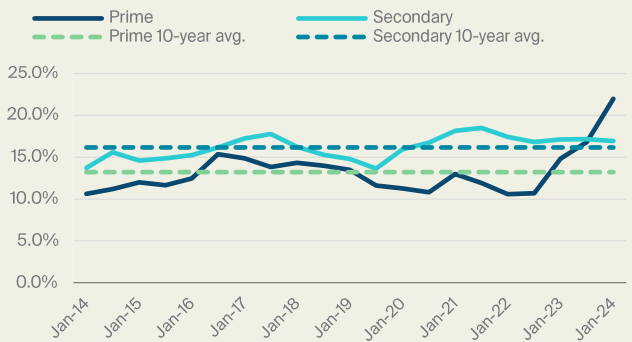
FLIGHT TO QUALITY THEME ONGOING

The flight-to-quality theme continues to be particularly relevant, evidenced by new generation office space (completed since 2006) continuing to attract the most significant interest, overshadowing the more challenging leasing conditions for secondary assets.

The spread between prime and secondary stock is wider than it has ever been. Older generation prime stock recorded vacancy of 32.2% in H2 2023, while new generation stock vacancy landed at 9.3% over the period. Without capital investment, refurbishments and quality upgrades, this gap is likely to continue to widen.

CBD office vacancy by grade

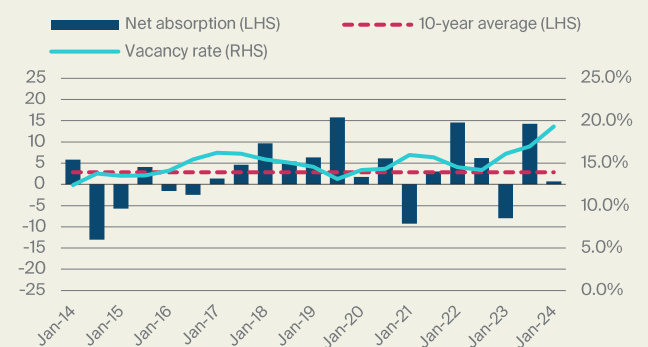
% prime vs secondary



Source: Knight Frank Research, PCA

CBD office net absorption and vacancy rate

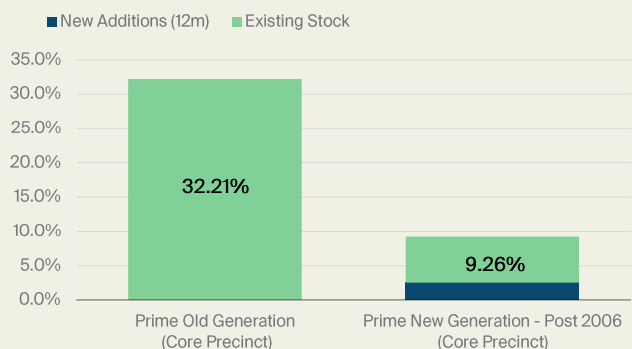
by 000's sqm and %



Source: Knight Frank Research, PCA

Core precinct prime CBD vacancy rate

by generation (old/new), %



Source: Knight Frank Research

Development supply

NEW SUPPLY TAPERS OFF IN 2024

Adelaide’s CBD office market experienced an influx of new office supply in H2 2023. The completion of two major A-grade office buildings, Walker Corporation’s One Festival Tower and Palumbo’s development at 185 Pirie Street, contributed a substantial 46,328sqm of new supply to the market.

One Festival Tower is a prime 24-storey office tower with approximately 40,000sqm of office supply with ground floor retail. Close to 90% of available space in the tower was pre-committed prior to completion, including commitments from Flinders University, Deloitte and Allianz. Added to this was 40,000sqm of office space delivered with the completion of Charter Hall’s 60 King William Street project which also arrived virtually fully let.

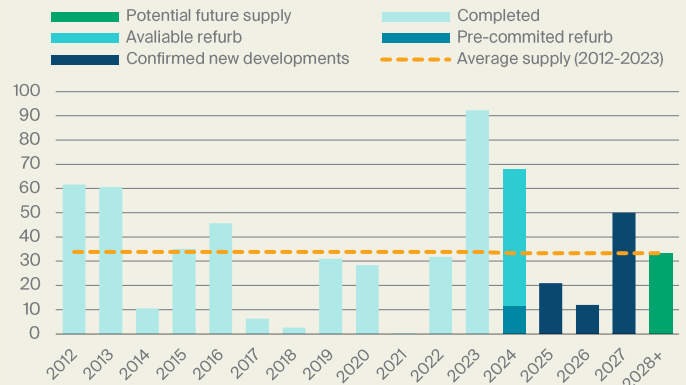
Looking ahead, there are several major refurbishments completing in 2024 improving the quality of space in the CBD. However, the total gross supply forecast for 2024 is a notable decrease from the record supply additions seen in 2023, reflecting a moderation in new developments. Future forecasts indicate a transition in supply dynamics, with expectations of just 21,000sqm approximately for 2025. The next major tower to land in the market will be Walker Tower 2 which is expected to deliver 50,000sqm of new space in 2027.

FUTURE SUPPLY UNCERTAIN IN 2026 AND BEYOND

Peak construction costs, increased interest rates and extended development timeframes have made additional tower starts significantly more difficult. However, there is still approximately 100,000sqm of new development projects expected or being planned, that are in a preliminary stage the most likely of which we include in the pipeline. Though it is unlikely that all projects will eventuate, there are a couple with a good likelihood of being built.

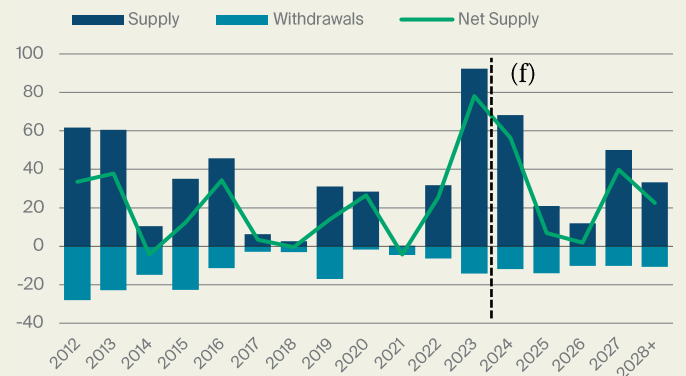
One such project is Market Square, ICD Property Group’s three-tower complex at Adelaide Central Market, with demolition having commenced in H2 2023. Despite delays, the first stage of the retail and residential components are underway, with the total project slated for completion in 2026.

Adelaide CBD development pipeline
by 000’s sqm



Source: Knight Frank Research

Adelaide CBD supply and withdrawals
by 000’s sqm

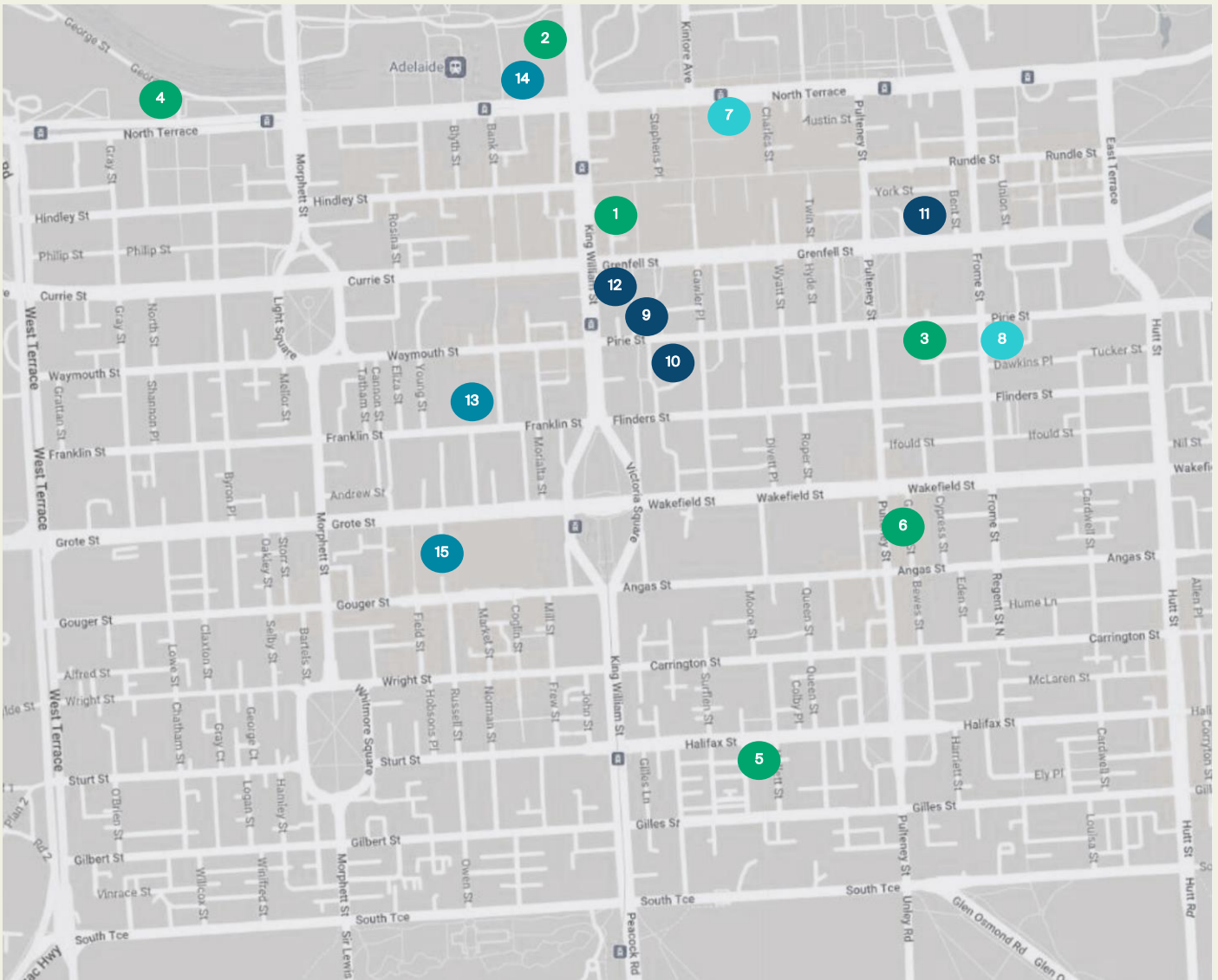


Source: Knight Frank Research

CHANGE OF USE WITHDRAWAL

During the six months to January 2024, the market saw the withdrawal of 80 King William Street, (removing 7,965sqm from available supply) due to a change of use, with plans to convert the building into a hotel. With the continued upgrading of the CBD offer we expect further withdrawals to occur to refurbish or reinvent.

Major office supply



Completed

#	ADDRESS	SQM	COMPLETION
1	60 King William St	40,000	Completed
2	One Festival Tower	44,500	Completed
3	185 Pirie St	6,328	Completed
4	SAHMRI 2	20,000	Completed
5	91 Halifax Street	627	Completed
6	274 Pulteney St	1,890	Completed

Mooted / DA Approved

#	ADDRESS	SQM	COMPLETION
7	200 North Terrace	26,000	n/a
8	120 Frome Street	7,310	n/a

Major Refurbishments

#	ADDRESS	SQM	COMPLETION
9	30 Pirie Street	24,000	H2 2024
10	45 Pirie Street	24,000	H2 2024
11	150 Grenfell St	9,485	H2 2024
12	100 King William Street	15,112	H2 2024

Under Construction / Major Pre-commitment

#	ADDRESS	SQM	COMPLETION
13	42-56 Franklin St	21,000	H2 2025
14	Market Square	12,000	H2 2026
15	Walker Tower 2	50,000	H2 2027

Rents & incentives

RENTAL GROWTH STATUS QUO

There has been a notable increase in gross rental rates in H2 2023, with growth projected to continue. In the six months to January 2024, Adelaide CBD's average gross face rents for prime and secondary stock rose by 7.00% (up \$42/sqm to \$649/sqm) and 2.63% (up \$12/sqm to \$455/sqm), respectively. Adelaide's CBD continued to outperform other capital cities in terms of rental growth, mainly due to a strong occupancy recovery post COVID-19 and a lower cost base than the other states.

As a result of the significant new supply additions and refurbished stock in 2023/4, tenants have a variety of options, creating a competitive environment. Expectations are that incentives for older and low A grade property will rise as building owners seek to fill vacancies. This trend is already evident, with average prime incentives rising from 31.8% to 34.1% in H2 2023, while secondary incentives declined from 37.9% to 37.5%.

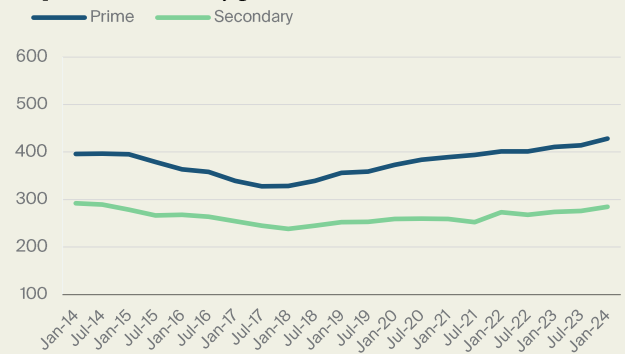
In H2 2023, prime and secondary gross effective rents rose by 3.35% (\$414/sqm to \$428/sqm) and 3.27% (\$276/sqm to \$285/sqm), respectively.

LOOKING FORWARD - RENTAL GROWTH FORECASTS

The three-year compound growth rate forecasts indicate an average annual increase of 4.5% in prime gross effective rents up to 2026, while face rents are expected to grow at an average annual rate of 3.2%.

CBD gross effective rents

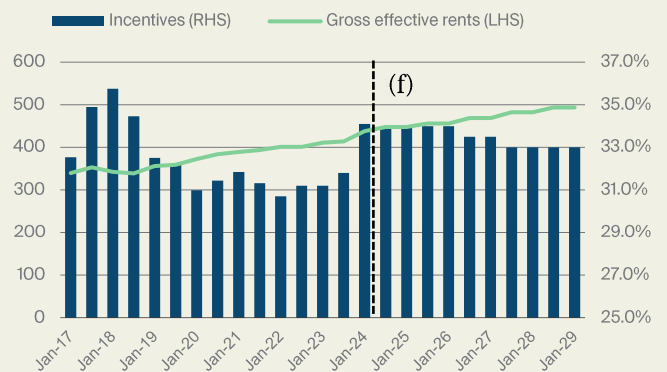
\$/sqm effective rents by grade



Source: Knight Frank Research

CBD prime rents and incentives

by \$/sqm, and %



Source: Knight Frank Research

Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent \$/sqm	Term yrs	Start Date
Telstra	60 King William Street	Core	4,500	540 n	7	Jul-23
WGA	61-69 Wyatt Street	Core	1,185	591 g	7	Jul 23
Enzen Global	1 King William Street	Core	1,160	628 g	5	Sep 23
WSP	83 Pirie Street	Core	2,726	670 g	8	Oct 23
SA State Government	11 Waymouth Street	Core	2,928	640 g	10	Feb 24

Source: Knight Frank Research/PCA * assuming WALE 5 years n Net g Gross

Investment

LIMITED TRANSACTION ACTIVITY IN H2 2023

Through H2 2023, only one transaction above \$10m settled in the Adelaide CBD, being 99 Frome Street, selling to a local private buyer for \$13.0m (7.52% Core Market Yield 'CMY').

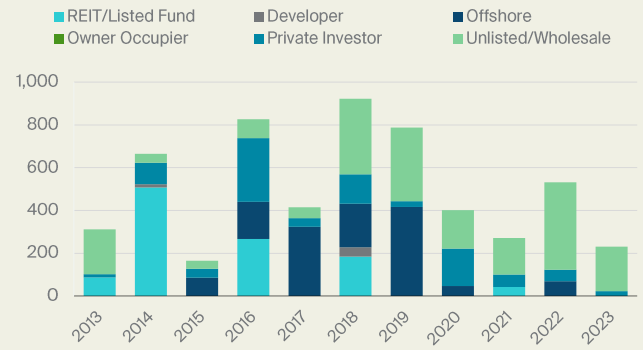
Despite the lack of CBD activity in H2 2023, there were two significant metropolitan sales that provide context to market movements. The first, a Department of Defence occupied asset at 620 Mersey Road, Osborne sold to the tenant, the Commonwealth of Australia (CoA) for \$46m (6.46% CMY). While the asset was purchased by the vendor, Australian Unity, in November 2020 for \$48.25m (5.07% CMY), it is still a strong result, reflective of CoA's strategic commitment to a significant and long-standing defence industry presence on the Lefevre Peninsula, and in SA more generally.

The other significant metro sale was Lockheed Martin's campus office at Mawson Lakes, which Knight Frank sold off-market to GDA Diversified Property Trust on behalf of an interstate private investor for \$28.2m (7.06% CMY). There are also several CBD transactions that have exchanged but are pending settlement, implying activity is returning.

YIELD CONTINUES SOFTENING BUT PACE SLOWING

In the current climate of diminished market activity, the average prime yields in the CBD have continued to soften, rising an additional 12 bps in the second half of 2023. This increase represents a significant rise of 179 bps from the historically low figures seen in the last quarter of 2021. Notably, the pace at which yields are softening has slowed markedly, indicating the smallest semi-annual change since the onset of this downward cycle.

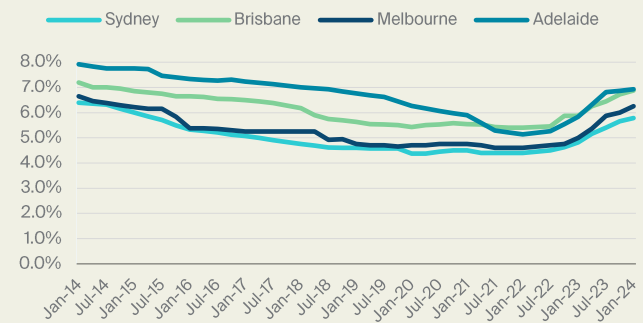
CBD office investment turnover
by investor type, \$ millions



Source: Knight Frank Research

CBD office core market yield

by major city, %



Source: Knight Frank Research

Recent significant sales

Property	Price \$ m	Core Market Yield %	NLA sqm	\$/sqm NLA	WALE	Purchaser	Vendor	Sale Date
63 Pirie Street*	58.60	7.01	11,210	5,227	3.40	Capital Property Funds	Raptis Group	U/C
104 Frome Street*	CONF	c.8.5	4,387	CONF	1.70	Private	Private	U/C
1 Richmond Road ^F	38.25	7.84	8,087	4,730	3.51	Centuria Property Funds	Lleyton Funds	U/C
99 Frome Street	13.00	7.52	3,432	3,788	1.01	Private	Private	Jul 23
45 Pirie Street	76.50	7.23	19,611	7,394	0.30	Curated Capital	AEP Investment	May 23
50 Hindmarsh Square	10.64	6.09	2,170	4,903	2.40	Pelligra Group	PPI Funds Management	Mar 23

Source: Knight Frank Research ^ includes income support * Not settled ^F Fringe Sale CONF Confidential

Fringe market

AVAILABILITY UP TO ITS HIGHEST LEVEL IN A YEAR

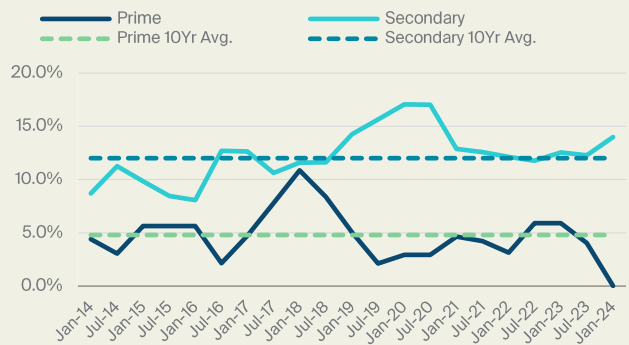
During the second half of 2023, vacancy rates in the Adelaide City Fringe increased from 10.4% to 11.1%. There was a significant decline in premium vacancies to zero, contrasted by the rise in secondary vacancies by 172 bps to 14.04%. This jump is mainly due to low demand for older, less-equipped properties when high-quality prime spaces are available. However, with prime locations now fully occupied, tenants may have to settle for secondary spaces or pay higher rates to move into the CBD.

The Fringe market recorded a net absorption of 172sqm in H2 2023, above the 10-year average of -355sqm. Despite the Fringe's challenges, its proximity to the CBD still attracts businesses. Areas like Mawson Lakes are becoming popular alternatives, but the Fringe remains competitive, evidenced by a recent lease along Fullarton Road by a non-profit aged care provider at \$422/sqm per annum gross of NLA.

Over the past six months, the Fringe saw a rise in prime gross effective rents to \$369/sqm, up by \$5/sqm, while secondary gross effective rents fell to \$272/sqm from \$287/sqm. Incentives have increased across the board, reaching 27% for prime assets and 30% for secondary, despite average outgoings maintaining their levels for both categories. Average prime yields have softened by 35 bps, moving from 6.88% to 7.23%, after a previous increase in the first half of the year, whereas secondary yields have held steady at 7.40%.

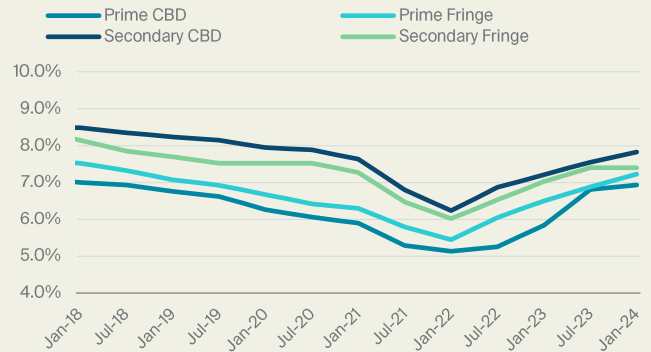
A significant transaction of note in the Fringe market is the pending sale of 1 Richmond Road, Keswick. The Centuria-owned property is currently under contract for \$38.25m to Lleyton Funds for a CMY of 7.84%.

Fringe office vacancy by grade, %



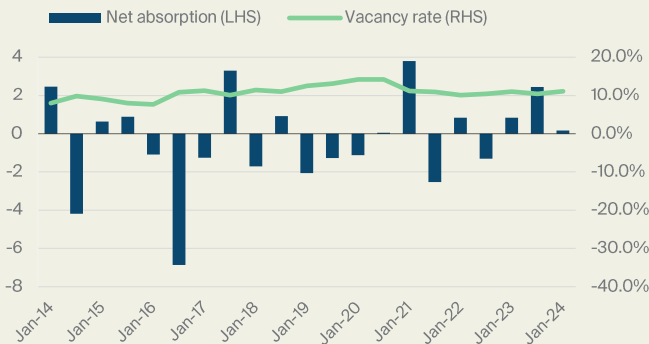
Source: Knight Frank Research

Adelaide Fringe and CBD core market yields by grade, %



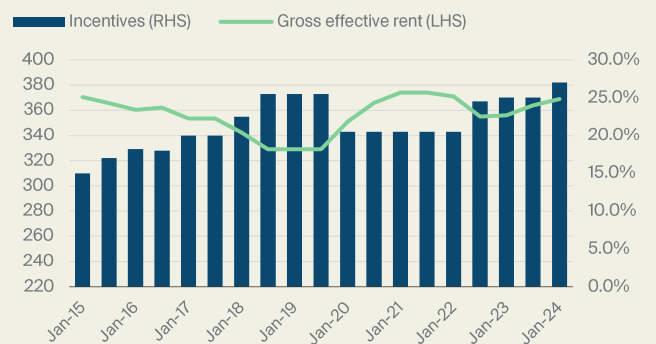
Source: Knight Frank Research

Adelaide fringe office vacancy & absorption by 000's sqm and %



Source: Knight Frank Research, PCA

Adelaide fringe prime office rents & incentives by \$/sqm and %



Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.



Research & Consulting
Bradley Tobiassen
+61 8 8233 5294
Bradley.Tobiassen@au.knightfrank.com



Institutional Sales
Max Frohlich
+61 8233 5267
Max.Frohlich@au.knightfrank.com



Valuation & Advisory
Nick Bell
+61 8 8233 5242
Nick.Bell@sa.knightfrankval.com.au



Research & Consulting
Dr Tony McGough
+61 3 9604 4608
Tony.McGough@au.knightfrank.com



Office Leasing
Martin Potter
+61 8 8233 5208
Martin.Potter@au.knightfrank.com

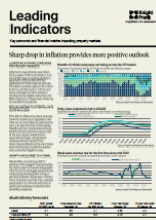


Office Leasing
Rory Dyus
+61 8233 5261
Rory.Dyus@au.knightfrank.com



Research & Consulting
Ben Burston
+61 2 9036 6756
Ben.Burston@au.knightfrank.com

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